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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

No. 62

NORTHERN NATURAL GAS COMPANY,
Appellant,

vs.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS,
Appellee,

Appeal From the Supreme Court of the State of Kansas

BRIEF OF AMICI CURIAE OF THE STATES OF: TEXAS, ALABAMA, COLORADO, GEORGIA, ILLINOIS, LOUISIANA, MISSISSIPPI, MONTANA, NEBRASKA, NEVADA, NEW MEXICO, NORTH DAKOTA, OKLAHOMA, UTAH, AND WYOMING

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This brief of amici curiae urging affirmance of Nos. 42,127 and 42,128, both styled Northern Natural Gas Company v. State Corporation Commission, 188 Kan. 351, 362 P. 2d 609, and 188 Kan. 355, 362 P. 2d 599, respectively, is filed on behalf of the States listed below by the Attorney Generals indicated. The States filing this brief, which are the principal oil and gas producing jurisdictions not directly involved in the present litigation, are vitally concerned with the outcome of this case because the very future of state regulation of oil and gas production is at stake. In the event this court now determines that states may not regulate oil and gas production if there is any possibility that such regulation may incidentally affect sales of gas in inter-

state commerce, the result will be to resubject the oil and gas industry to the economic chaos and attendant waste prevalent before passage of state proration statutes. Because of the extreme importance of the issues involved and because of their broad experience in the administration of proration statutes, the following States respectfully request permission to file this brief as amici curiae:

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Alabama	MacDonald Gallion
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Louisiana	Jack P. F. Gremillion
Mississippi	Joe T. Patterson
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Nevada	Charles E. Springer
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Utah	A. Pratt Kesler
Wyoming	W. M. Haight
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Texas proration statutes and procedures and cases litigating these procedures have been used in this brief by way of example. While the applicable statutes and case laws of other jurisdictions joining in this brief are not necessarily identical to those of Texas, insofar as such statutes and laws form the background of proration and will be af-

fected by this case, the Texas materials are representative.

Statement of Facts

Prior to 1958 the State Corporation Commission of the State of Kansas, in accordance with the usual procedure of state regulatory bodies, established allowables in the Kansas-Hugoton Field by calculating the total demand for gas from the field on the basis of projected purchases nominated by all pipelines connected to the field. The Commission then prorated production from the various gas wells in the field to insure to each producer his fair share of the total market demand. Hearings held by the Commission in early 1958 revealed that reserves of Kansas producers were being systematically drained under established allowables because pipeline purchasers were making lower nominations (estimates of projected purchases) and were taking a much smaller percentage of reserves from Kansas than from Texas and Oklahoma portions of the field. (See memorandum for the Federal Power Commission as amicus curiae previously filed in this cause at page 4 thereof.)

Despite the fact that its markets were at the time inadequate to insure Kansas producers sufficient production to allow them their fair share of the gas in the Hugoton Field, Northern Natural Gas Company proceeded to acquire enormous additional reserves of gas (See testimony of Rex D. Fowler, Transcript p. 32). These acquisitions apparently were made upon the unwarranted assumption that

the Federal Power Commission would quickly allow expansion into new markets (Transcript p. 85). Northern Natural drastically reduced its already inadequate purchases from the Kansas-Hugoton Field in early 1958 (Transcript p. 32), presumably in order to avoid payment for gas not taken from the new reserves which it had acquired because of its oversanguine expectations.

Because of Northern Natural's discrimination against Kansas producers, the State Corporation Commission was compelled to alter its policy of relying solely upon pipeline nominations in setting allowables in the Kansas-Hugoton Field. As a consequence, in early 1958 new allowables were established which were more in line with Kansas' fair share of production from the field; that is to say more nearly proportional in comparison to reserves to the rate of production in Texas and Oklahoma. In establishing these allowables, the Commission was attempting to insure to each owner of oil and gas the opportunity to produce the oil and gas in place underneath the land which he owned.[1]

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[1] The Texas statute establishing the duties of the Texas Railroad Commission is Article 6008, Vernon's Annotated Texas Statutes, provides in part as follows:

"Sec. 10. It shall be the duty of the Commission to prorate and regulate the daily gas well production from each common reservoir in the manner and method herein set forth. The Commission shall prorate and regulate such production for the protection of public and private interests:

"(a) In the prevention of waste as 'waste' is defined herein;

"(b) In the adjustment of correlative rights and opportunities of each owner of gas in a common reservoir to produce and use or sell such as permitted in this Article."

The increased allowables resulted in inequitable taking as among Kansas producers, however. Northern Natural Gas Company has connections with over 1200 wells in the Kansas portion of the field, but its only contract containing a "take-or-pay" provision is that with Republic Natural Gas Company. This provision requires Northern Natural to take a specified quantity of gas or to pay a determinable sum of money if that amount of gas is not taken.[1] In order to avoid having to pay under the terms of the Republic contract for gas not taken, Northern Natural took the entire allowable from the Republic wells, but underproduced all other Kansas wells to which it was connected. The owners were prevented from obtaining any additional market for the underproduced wells because their entire reserves were committed to contracts within the jurisdiction of the Federal Power Commission.

Reference to Northern Natural's Exhibit No. 7 put into evidence in the Commission hearing (Transcript p. 83), reveals the extent of Northern Natural's discrimination against all producers other than Republic Natural Gas Company. As of April 1, 1958, non-Republic wells were underproduced by one month's allowable, while by December 15th of that year, the wells were underproduced in the

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[1] Contrary to the situation suggested by the facts in this case, most gas purchase contracts involving sales into interstate commerce contain "take-or-pay" clauses. It has been held, however, that a purchaser is not required to pay under such a clause if taking the allowable production from the well or wells involved. See Northern Natural Gas Co. v. Republic Natural Gas Co., 172 Kan. 450, 241 P. 2d 708 (1952).

amount of five months' allowables. A rough computation demonstrates that only about one-half as much gas was taken from each of the non-Republic wells during the period as had been taken from each Republic well.

In order to prevent drainage as among Kansas owners while still allowing them to produce their fair share of the total gas in the reservoir, the Commission issued the ratable take order involved in this case. A ratable take order requires each purchaser to take gas from all wells to which he is connected in proportion to the allowables of the wells. It does not require the purchaser to take *any particular volume of gas* but only that his taking of gas must be *fairly apportioned* among the various wells to which he is connected. Thus, the purpose of the ratable take order was to implement state production regulations designed to protect the correlative rights of owners and producers of gas. In the absence of such an order, certain Kansas owners were grossly favored by Northern Natural over other owners in the same field. Since it is possible for a relatively small number of wells to drain a gas reservoir, those owners and producers discriminated against would ultimately lose by drainage much of the gas under their lands.

By means of the present scheme of regulation, during the calendar year of 1961 each of the Kansas producers connected to Northern Natural was able to produce at least 80 per cent of the gas to which he was entitled (See memorandum for the Federal Power Commission as amicus curiae previously filed

in this cause at page 3 thereof), while prior to issuance of the ratable take order most owners were able to produce less than 50 per cent of their fair share. Thus the ratable take order working in conjunction with appropriately established allowables has resulted in effective protection of correlative rights.

It is of especial interest that there is no evidence in this case that Northern Natural *has ever been obligated to pay for gas not taken* or *will ever be forced* by these reasonable orders. Thus, *what Northern Natural really seeks in this case is an unrestricted license to discriminate against some or all Kansas owners and producers of natural gas.*

Argument

THE NATURAL GAS ACT DOES NOT PRECLUDE STATE REGULATION OF PRODUCTION OF OIL AND GAS EVEN WHERE SUCH REGULATION MAY HAVE AN INCIDENTAL EFFECT UPON SALES OF GAS IN INTERSTATE COMMERCE.

1. *"Production or gathering" is specifically excepted from the application of the statute.*

Section 1 (b) of the Natural Gas Act [52 Stat. 821 (1938); 15 U.S.C. § 717 (b)] provides as follows:

> "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas

companies engaged in such transportation or sale, but *shall not apply* to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or *to the production or gathering of natural gas.*" (Emphasis supplied)

In interpreting this language in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), the Court said: "There can be no dispute that the overriding congressional purpose was to plug the 'gap' in regulation of natural gas companies resulting from judicial decisions prohibiting, on federal constitutional grounds, state regulation of many of the interstate commerce aspects of the natural gas business."

The right of states to regulate production and gathering of oil and gas for the purpose of preventing waste, protecting correlative rights, and preventing drainage was well established at the time the Natural Gas Act was passed, this right including the power to issue ratable take orders.[3] Conse-

[3] Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900); Champlin Refining Co. v. Corporation Commission, 286 U.S. 210 (1932). See also Summers, The Law of Oil and Gas (2d ed.) § 106, p. 174 and particularly the cases cited in note 44 to said section. Litigation in connection with Sections 8a and 8aa, Article 6049a, V.A.T.S., the Texas Statutes authorizing ratable take orders, is of especial interest. In 1932 an order under Section 8aa was held invalid as burdening interstate commerce because the order extended the Common Purchaser Statute to pipelines which were not common carriers. Texoma Natural Gas Co. v. Railroad Commission of Texas, 59 F 2d 750 (D.C. 1932). This court in Thompson v. Consolidated Gas Utilities Corp., 300 U.S.

quently, the above language of the National Gas Act should be read as excepting from the jurisdiction of the Federal Power Commission the regulation of gas production for the purpose of protecting correlative rights and preventing waste and drainage, even where such regulation has an incidental effect upon the amount of gas sold into interstate commerce under a given contract or upon the total price paid for its gas requirements by a given interstate pipeline purchaser. *Thus it was to allow exactly the type of state regulation complained of in this case that the "production or gathering" exception was incorporated into the Natural Gas Act.*

Appellant appears to rely principally upon the following three cases: *Phillips Petroleum Co. v. Wisconsin, supra; Natural Gas Pipe Line Co. v. Panoma Corp.*, 349 U.S. 44 (1955); and *Cities Service Gas Co. v. State Corp. Comm'n of Kansas*, 355 U.S. 391 (1958). The *Phillips* case, as shown above, plainly supports the construction of the Natural Gas Act urged in this brief. The other two cases cited deal with state attempts to fix the price of gas sold into interstate commerce. The orders there under attack did not regulate production or involve protection of correlative rights or prevention of drainage or waste.

55 (1936), at pages 78 and 79, lays especial emphasis upon the fact that in the Texoma case the pipelines were not common carriers, distinguishing the "Assigned Car Cases" upon that ground. A close reading of these two cases demonstrates that prior to the passage of the Natural Gas Act, ratable take orders issued under Section 8a were considered by the Federal Courts to be a valid exercise of state police power in the regulation of production of gas insofar as common carriers were concerned. See also discussion of the *Peerless* case below.

The true significance of the *Panoma* and *Cities Service* cases can be understood only in connection with *Cities Service Gas Co. v. Peerlees Oil & Gas Co., et al*, 340 U.S. 179 (1950). That case involved an order setting a minimum wellhead price and ratable take order. Cities Service was draining gas from reserves which Peerless was unable to produce for lack of a market. Cities Service refused to purchase any gas from Peerless except at a price which would have amounted to confiscation. Consequently, the Oklahoma Corporation Commission ordered Cities Service to connect with the Peerless wells and purchase the output ratably at a price fixed by the Commission. The orders were held not to be an unreasonable burden on interstate commerce.

The Court, in its discussion, upheld state ratable take orders in unequivocable terms: "The Due Process and Equal Protection issues raised by appellant are virtually without substance. It is now undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas. This Court has upheld numerous kinds of state legislation designed to curb waste of natural resources and to protect the correlative rights of owners through ratable taking, Champlin Refining Co. v. Corporation Commission, 286 U.S. 210, 76 L ed. 1062, 52 S. Ct. 559, 86 ALR 403 (1932), or to protect the economy of the state. Railroad Commission v. Rowan & Nichols Oil Co., 310 U.S. 573, 84 L ed. 1368, 60 S. Ct. 1021 (1940). These ends have been held to justify control over production even though the uses to which property may profit-

ably be put are restricted. Walls v. Midland Carbon Co. 254 U.S. 300, 65 L ed 276, 41 S. C. 118 (1920)."

The Court further held that incidental leverage on interstate pipeline purchasers would not invalidate such an order, saying: "A state is justifiably concerned with preventing rapid and uneconomic dissipation of one of its chief natural resources. The contention urged by appellant that a group of private producers and royalty owners derive substantial gain from the regulations does not contradict the established connection between the orders and a state-wide interest in conservation. Cf. Thompson v. Consolidated Gas Co. 300 U.S. 55, 81 L. ed. 510, 57 S. Ct. 364 (1937)." The Court goes on to point out that *only* in connection with the *price fixing feature* of the *Peerless* case was the effect of the Natural Gas Act ignored: "Whether the Gas Act authorizes the Power Commission *to set field prices on sales* by independent producers, or leaves that function to the states, is not before this court." (emphasis supplied) The *Panoma* case, which is cited by the *Cities Service* case, distinguishes the *Peerless* case solely on the basis of the quoted language excluding the Natural Gas Act from consideration in connection with price fixing. Thus, the *Peerless* case and the interpretation of the *Peerless* case in the *Panoma* and *Cities Service* cases demonstrate the position of this court to be that an appropriate ratable take order is a valid regulation of gas production necessary to effective state regulation for purposes of conservation.

In summary, the real purpose of the "production and gathering" exception was to make certain that the Natural Gas Act did not interfere with effective state regulation for conservation purposes, including the protection of correlative rights. The cases cited, together with the facts of the instant case and of the *Peerless* case, demonstrate that effective protection of correlative rights can be achieved in certain situations only by issuance of appropriate ratable take orders. Ratable take orders have consistently been upheld by this court in the face of attacks on almost all conceivable grounds.

2. *Appellant's theory as to the effect of filing gas purchase contracts with the Federal Power Commission would make unworkable state regulation of oil and gas production.*

Over three-fourths of the oil produced in the State of Texas is produced in association with gas sold into interstate commerce. Because such associated gas cannot be produced without also producing the oil in which it is dissolved, state regulation of oil production must necessarily affect the amounts of gas sold into interstate commerce under the terms of various contracts properly filed as rate schedules with the Federal Power Commission and must have some effect upon the prices paid for their total gas requirements by interstate gas pipeline companies.

The only logical conclusion of Appellant's argument as to the sacrosanctity of each and every provision of contracts filed with the Federal Power

Commission as rate schedules is that any state order which *might possibly* increase the overall price paid by an interstate pipeline company for its requirements of gas would be void as in contravention of the authority of the Federal Power Commission under the Natural Gas Act. Since only a small fraction of oil and gas production would be subject to state control, no effective regulation of production of either oil or gas could be exercised by state regulatory bodies. That this result is absolutely contrary to the intent of Congress both prior and subsequent to the passage of the Natural Gas Act is demonstrated by the many Congressional resolutions in connection with the Interstate Oil Compact.[1]

3. *The construction argued by Appellant contradicts its position in connection with the effect of state established allowables on "take-or-pay" provisions.*

Appellant herein, by its reliance upon and acceptance of benefits under the judgment in the case of *Northern Natural Gas Co. v. Republic Natural Gas Co.*, 172 Kan. 450, 241 P. 2d 708 (1952), admits that a state proration order restricting allowables has the effect of reducing the required "take" under a "take-or-pay" provision even though the "take-or-pay" provision is contained in a contract properly filed with the Federal Power Commission as a rate schedule under the terms of the Natural Gas Act. Thus Appellant seems to reason that state

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[1] See for example H.R.J. Res. 407, 74th Cong., 1st Sess., 79 Cong. Rec. 14584 (1935); H.R.J. Res. 329, 76th Cong., 1st Sess., 84 Cong. Rec. 8980 (1939).

regulation *reducing* the sums. Appellant would, in the absence of such regulation, be obligated to pay is in no way in conflict with the Natural Gas Act, but that any regulation which might *possibly* have the effect of slightly *increasing* the costs of a gas pipeline company is in contravention of the Natural Gas Act.

Certainly Appellant can find no support for this position in the Natural Gas Act, which simply requires that "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." [52 Stat. 822 (1938); 15 U.S.C. § 717c]

4. *Appellant's construction of the Natural Gas Act has already been negatived by the Permian case.*

There is no distinction between this case and the case of *Permian Basin Pipeline Co. v. Railroad Comm'n of Texas*, 358 U.S. 37 (1958). In that case the Railroad Commission of Texas entered orders having the effect of prorating the production of gas from the Puckett-Ellenburger Field and of requiring the pipeline company to purchase ratably from the operators in the field the gas so produced. These orders also had the effect of reducing the amounts of gas sold by Phillips Petroleum Company[5] under the

[5] Phillips Petroleum Company was declared by this Court to be a natural gas company subject to the provisions of the Natural Gas Act in Phillips Petroleum Co. v. Wisconsin, *supra*.

terms of its contracts with Permian. It was contended that these orders constituted a burden on interstate commerce and encroached on the jurisdiction of the Federal Power Commission. The orders were upheld by the Texas courts on appeal, and this Court dismissed application for writ of certiorari. In so doing, we submit that this Court implied that it did not view a state ratable take order incidentally affecting the amount or price of sales of gas into interstate commerce as violating the Natural Gas Act.

Conclusion

The States joining in this brief believe, and experience has proved, that state regulation of oil and gas production is essential to the orderly development of the industry and to conservation of these vital natural resources. There is nothing in the Natural Gas Act which provides any basis for imputing to the Congress the intention to bar effective state regulation, which would be the result if Appellant's position in this case were sustained.

It is respectfully submitted that the judgment below should be affirmed.

Respectfully submitted,

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